

806 KAR 12:120. Suitability in annuity transactions.

RELATES TO: KRS 304.9-390, 304.12-010, 304.99-020, 26 U.S.C. 401, 403, 408, 414, 457, 29 U.S.C. 1001-1461

STATUTORY AUTHORITY: KRS 304.2-110

NECESSITY, FUNCTION, AND CONFORMITY: KRS 304.2-110(1) authorizes the Commissioner of Insurance to promulgate administrative regulations necessary for or as an aid to the effectuation of any provision of the Kentucky Insurance Code, KRS Chapter 304. This administrative regulation establishes standards and procedures for recommendations to consumers that result in a transaction involving annuity products so that the insurance needs and financial objectives of consumers during the transaction are appropriately addressed.

Section 1. Definitions. (1) "Agent" is defined in KRS 304.9-020(1).

(2) "Annuity" is defined in KRS 304.5-030.

(3) "Commissioner" is defined by KRS 304.1-050(1).

(4) "Consultant" is defined in KRS 304.9-040.

(5) "FINRA" means the Financial Industry Regulatory Authority or a succeeding agency.

(6) "Insurance producer" is defined in KRS 304.9-020(10).

(7) "Insurer" is defined in KRS 304.1-040.

(8) "Licensee" means agent, or an insurer if an agent is not involved, and consultant.

(9) "Recommendation" means advice provided by a licensee to an individual consumer that results in a purchase, exchange, or replacement of an annuity in accordance with that advice.

(10) "Replacement" is defined in KRS 304.12-030(1)(a).

(11) "Suitability information" means information that is reasonably appropriate to determine the suitability of a recommendation in accordance Section 3(2).

Section 2. Exemptions. This administrative regulation shall not apply to recommendations involving:

(1) Direct response solicitations without a recommendation based on information collected from the consumer pursuant to this administrative regulation; or

(2) Contracts used to fund:

(a) An employee pension or welfare benefit plan covered by the Employee Retirement and Income Security Act (ERISA), codified as 29 U.S.C. 1001 to 1461;

(b) A plan described by 26 U.S.C. 401(a), (k), 403(b), 408(k), or (p), as amended, if established or maintained by an employer;

(c) A government or church plan defined in 26 U.S.C. 414, a government or church welfare benefit plan, or a deferred compensation plan of a state or local government or tax exempt organization under 26 U.S.C. 457;

(d) A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor;

(e) Settlements of or assumptions of liabilities associated with personal injury litigation or any dispute or claim resolution process; or

(f) Prepaid funeral contracts.

Section 3. Duties of Licensees. (1) In recommending to a consumer the purchase of an annuity or the exchange of an annuity that results in another insurance transaction or series of insurance transactions, the licensee shall have reasonable grounds for believing that the recommendation is suitable for the consumer on the basis of the facts disclosed by the consumer as to these investments and other insurance products and as to the consumer's financial situa-

tion and needs, including the consumer's suitability information, and that there shall be a reasonable basis to believe all of the following:

(a) The consumer has been informed of various features of the annuity, including:

1. The potential surrender period and surrender charge;
2. Potential tax penalty if the consumer sells, exchanges, surrenders or annuitizes the annuity;

3. Mortality and expense fees;

4. Investment advisory fees;

5. Potential charges for and features of riders;

6. Limitations on interest returns, insurance, and investment components; and

7. Market risk;

(b) The consumer would benefit from certain features of the annuity, including:

1. Tax deferred growth;

2. Annuitization; or

3. Death or living benefit;

(c) For the particular consumer, based on his or her suitability information, the transaction as a whole is suitable, including:

1. The type of annuity;

2. The underlying subaccounts to which the funds are allocated at purchase or exchange of the annuity;

3. The riders; and

4. The similar product enhancements; and

(d) If there is an exchange or replacement of an annuity, the exchange or replacement is suitable including taking into consideration whether:

1. The consumer shall:

a. Incur a surrender charge;

b. Be subject to the commencement of a new surrender period;

c. Lose existing benefits including death, living, or other contractual benefits; or

d. Be subject to increased fees, including:

(i) Investment advisory fees; or

(ii) Charges for riders and similar product enhancements;

2. The consumer would benefit from product enhancements and improvements; and

3. The consumer has had another annuity exchange or replacement and in particular, exchange or replacement within the preceding thirty-six (36) months.

(2) Prior to the execution of a purchase, exchange, or replacement of an annuity resulting from a recommendation, the licensee shall make reasonable efforts to obtain the consumer's suitability information including the following:

(a) Age;

(b) Annual income;

(c) Financial situation and needs, including the financial resources used for the funding of the annuity;

(d) Financial experience;

(e) Financial objectives;

(f) Intended use of the annuity;

(g) Financial time horizon;

(h) Existing assets, including investment and life insurance holdings;

(i) Liquidity needs;

(j) Liquid net worth;

(k) Risk tolerance; and

(l) Tax status.

(3) Except as permitted under subsection (4), an insurer shall not issue an annuity recommended to a consumer unless there is a reasonable basis to believe the annuity is suitable based on the consumer's suitability information.

(4)(a) Except as provided under paragraph (b) of this subsection, the licensee shall not have an obligation to a consumer under this subsection or subsection (1) of this section related to an annuity transaction if:

1. A consumer refuses to provide relevant suitability information requested by the licensee and the annuity transaction is not recommended;

2. A consumer decides to enter into an insurance transaction not based on a recommendation of the licensee;

3. A recommendation was made and was later found to have been prepared based on materially inaccurate information provided by the consumer; or

4. No recommendation is made.

(b) A licensee's recommendation subject to paragraph (a) of this subsection shall be reasonable under all the circumstances actually known to the licensee at the time the annuity is issued.

(5) A licensee shall at the time of sale:

(a) Make a record of any recommendation subject to section 3(1) of this administrative regulation;

(b) Obtain a consumer signed statement documenting a consumer's refusal to provide suitability information, if any; and

(c) Obtain a consumer signed statement acknowledging that an annuity transaction is not recommended if a consumer decides to enter into an annuity transaction that is not based on the licensee's recommendation.

(6)(a) An insurer shall establish a system that is reasonably designed to achieve a licensee's compliance with this administrative regulation, including the following:

1. The insurer shall maintain reasonable procedures to inform its licensees of the requirements of this administrative regulation and shall incorporate the requirements of this administrative regulation into relevant insurance licensee training manuals.

2. The insurer shall establish standards for licensee product training and shall maintain reasonable procedures to require its licensees to comply with the requirements of Section 4 of this administrative regulation.

3. The insurer shall provide product-specific training and training materials which explain all material features of its annuity products to its licensees.

4. The insurer shall maintain procedures for review of each recommendation prior to issuance of an annuity that are designed to ensure that there is a reasonable basis to determine that a recommendation is suitable.

a. These review procedures may apply a screening system for the purpose of identifying selected transactions for additional review and may be accomplished electronically or through other means including physical review.

b. This electronic or other system for review procedures may be designed to require additional review only of those transactions identified for additional review by the selection criteria.

5. The insurer shall maintain reasonable procedures to detect recommendations that are not suitable. This may include confirmation of consumer suitability information, systematic customer surveys, interviews, confirmation letters and programs of internal monitoring. An insurer may comply with this subparagraph by applying sampling procedures, or by confirming suitability information after issuance or delivery of the annuity.

6. The insurer shall annually provide a report to senior management, including to the senior

manager responsible for audit functions, which details a review, with appropriate testing, reasonably designed to determine the effectiveness of the supervision system, the exceptions found, and corrective action taken or recommended, if any.

(b)1. An insurer may contract for performance of a function, including maintenance of procedures, required under paragraph (a) of this subsection.

2. An insurer's supervision system under paragraph 1. shall include supervision of contractual performance under this subsection. This shall include the following:

a. Monitoring and, as appropriate, conducting audits to assure that the contracted function is properly performed;

b. Annually obtaining a certification from a senior manager who has responsibility for the contracted function that the manager represents, that the function is properly performed; and

3. If an insurer contracts for performance of a function and supervises the performance of the contract in accordance with subsection (6)(b)2 of this section, the insurer shall remain responsible for taking appropriate corrective action and may be subject to sanctions and penalties pursuant to Section 5 of this administrative regulation.

(c) An insurer shall not be required to include in its system of supervision a licensee's recommendations to consumers of products other than the annuities offered by the insurer.

(7) A licensee shall not attempt to influence a consumer from:

(a) Truthfully responding to an insurer's request for confirmation of suitability information;

(b) Filing a complaint; or

(c) Cooperating with the investigation of a complaint.

(8)(a)1. Sales made in compliance with FINRA requirements pertaining to suitability and supervision of annuity transactions shall satisfy the requirements under this administrative regulation.

2. This subsection shall apply to FINRA broker-dealer sales of variable annuities and fixed annuities if the suitability and supervision is similar to those applied to variable annuity sales.

3. This subsection shall not limit the commissioner's ability to enforce the provisions of this administrative regulation.

(b) For paragraph (a) to apply, an insurer shall:

1. Monitor the FINRA member broker-dealer using information collected in the normal course of an insurer's business; and

2. Provide to the FINRA member broker-dealer information and reports that are reasonably appropriate to assist the FINRA member broker-dealer to maintain its supervision system.

(9) The requirements of this section are intended to supplement and not replace the disclosure requirements in 806 KAR 12:150.

Section 4. Licensee Training. (1) An agent shall not sell, solicit, or negotiate an annuity product unless the agent has completed training in accordance with 806 KAR 9:220, Section 5.

(2) A consultant shall not advise an individual regarding an annuity unless the consultant has completed the training in accordance with 806 KAR 9:220, Section 5.

(3) A licensee shall maintain records documenting compliance with the training requirements in subsection (1) and (2) of this section, which shall be available:

(a) To the department, if requested; and

(b) For a period not less than five (5) years.

(4) An insurer shall verify that an agent has completed the annuity training course required under this subsection before allowing the agent to sell an annuity product for that insurer.

Section 5. Mitigation of Responsibility. (1) An insurer shall be responsible for compliance with this administrative regulation. If a violation occurs, due to the action or inaction of the in-

suror or its licensee, the commissioner may require:

(a) An insurer to take appropriate corrective action for any consumer harmed by the insurer's, or by its agent's, violation of this administrative regulation;

(b) An agent to take appropriate corrective action for any consumer harmed by the insurance agent's violation of this administrative regulation; or

(c) A supervising insurance producer that employs or contracts with an insurance agent to sell, or solicit the sale, of annuities to consumers, to take appropriate corrective action for any consumer harmed by the agent's violation of this administrative regulation;

(2) The commissioner may require consultant to take appropriate corrective action for any consumer harmed by the consultant's violation of this administrative regulation.

(3) Any applicable penalty under KRS 304.99-020 for a violation of Section 3(1), (2), or (3) of this administrative regulation may be reduced or eliminated, if corrective action for the consumer is taken promptly after a violation is discovered.

Section 6. Recordkeeping. Licensees shall maintain records of the information collected from the consumer and other information used in making the recommendations that were the basis for insurance transactions in accordance with KRS 304.9-390 and 806 KAR 2:070. An insurer may maintain documentation on behalf of a licensee.

Section 7. Effective Date. The requirements of this administrative regulation shall not be implemented or enforced prior to the effective date, determined pursuant to KRS 13A.330, or January 1, 2012, whichever is later. (33 Ky.R. 4292; 34 Ky.R. 286; 728; eff. 11-2-2007; 37 Ky.R. 2754; 38 Ky.R. 44; eff. 9-2-2011; TAm eff. 4-10-2012; Crt eff. 2-26-2020.)